MR. HOENIG: Well, thank you very much, Mr. Chairman and Mr. Chairman. It's a pleasure for me to have this opportunity.

And I first want to welcome all of you to the Federal Reserve Bank of Kansas City. We are truly honored to host you here today and to also have the opportunity to listen to other participants on this very important topic.

And being an economist, when Wayne invited me to make comments, I could hardly refuse. So I hope you'll bear with me, because it is an important topic, and I do appreciate the opportunity to comment.

We are, as you know, in the midst of a vibrant U.S. economy, one that some would say is a booming economy. Last year, GDP grew again at a rate better than 4 percent.

And this is an exciting outcome, and I would suggest that there are three elements to this, the first being the fact that we've had some very good fiscal policy, and our deficit has become a surplus over the last couple of years.

And secondly, if I can say so, I think our monetary policies provided us an important environment of low and stable inflation.

And third, I do believe our trade policy has recognized the importance of free and open trade.

By adhering to these fundamentally sound policies, we have enjoyed a resurgence in productivity growth and living standards in the United States over the last few years.

And it's interesting to me at least that, while there seems to be agreement that replacing the fiscal deficit with surpluses and moving to an environment of stable prices and low inflation have contributed importantly to the stronger economy, there has been an increasing debate and less confidence, perhaps, regarding the benefits of our recent trade policies.

Now, there are any number of reasons for this erosion of confidence in our trade policy.

As witnessed by this Commission, for example, many people are concerned about the large and growing current account deficit.

By the end of last year, as others have noted, it was about 3.7 percent of our GDP, or $350 billion. And as recently as the end of 1997, it was a more modest 2 percent, still large, but it has certainly grown.

Thus, a large and growing current account deficit has caused some within the United States to begin questioning the wisdom of those policies that encourage open trade.

And the claim is, in part, that having opened U.S. markets to the rest of the world, we are undermining our economic growth and paying for other countries' prosperity with American jobs.

While understandable, I believe these kinds of objections are misplaced. I, too, am concerned with the U.S. having a large and growing current account deficit, but I do not consider the remedy of trade restrictions to be useful.

Certainly, a large and growing current account deficit poses a risk to the economic outlook and does raise questions.

For example, can the United States continue to act as the consumer of last resort for the rest of the world?

Will foreign investors be willing to continue lending to us? More generally, is the large and growing current account deficit even sustainable?

But these questions and the very fact of a current account deficit are issues of macroeconomics more than they are immediate trade policy.

Other legitimate concerns that I've heard here today, for example, focus on labor rights and working conditions or the effects of industrial development on the environment. These are important issues, without question. But restricting trade hardly strikes me as the best means of solving them.

Take the issue of labor conditions, for example. In studying the relationship between trade and labor standards, the Organization of Economic Cooperation and Development, in 1996, found that trade reforms, if sustained, lead to improvements in labor standards. And I think an early participant here made that remark.

That is, rising labor standards are the result of economic growth, not necessarily the cause, and that free trade is one of the main ways we bring about this result.

Perhaps these kinds of findings apply to other issues as well. We need to find this out before we draw conclusions.

Throughout history, even before Adam Smith wrote his famous "The Wealth of Nations", economic thinkers have repeated shown that open trade helps countries systematically raise their levels of wealth and income.

Issues of job displacement and transition represent legitimate concerns that have to be addressed. But as world trade has expanded, we have dealt successfully with these issues, and in the end, added to both wealth and jobs.

Let's take some facts that I would like to share with you today.

In 1947, one of the first postwar trade agreements was the General Agreement on Tariffs and Trade, or GATT, the predecessor to today's WTO.

GATT reflected the leadership of the United States in expanding the system of world trade. And since that time, tariffs in the United States, it has been noted, has fallen from about 20 percent then to about 5 percent today, and most of the gains have been passed to the consumer, raising our standard of living.

Since the first GATT agreement, the growth of real GDP in the United States has averaged nearly 3.5 percent per year.

Meanwhile, our real per capita GDP has surged from under $10,000 in 1947 to about $30,000 today.

For more than 100 countries of the United Nations, average real GDP growth since 1947 has even exceeded that of the United States, although many, of course, are starting from a lower base.

In 1995, economist Jeffrey Sachs, who I think most of you know, and his colleague, Andrew Warner, studied the effects of trade policies in dozens of countries.

Among the countries reviewed, he and Warner found that developed nations with open economies grew about 2-1/4 percent annually from 1970 to 1990, while developed nations with closed economies tended to grow a meager .7 percent.

The contrast among developing nations is even starker. Developing nations with open economies grew about 4-1/2 percent, while developing nations with closed economies grew less than 1 percent.

Countries that switched from closed to open economies saw their growth rates climb an average of more than a full percentage point a year.

In addition to these facts, consider that, despite their recent financial woes, South Korea, Singapore, Hong Kong, countries that have opened their doors, are far wealthier than countries with closed economies.

It is no coincidence that these three countries have grown two to four times faster than India, Brazil, and Mexico, countries that have been slower to open their doors to trade.

In Hong Kong, per capita GDP has soared from a U.S. equivalent of about $3,000 in 1970 to $18,000 today.

In China, the same measure of wealth has grown from about $100 to about $800, and most of that increase has occurred in the past ten years as China has really only recently begun to pry open its doors to trade.

In other words, what this information and history show is that trade is good for each of the participating countries.

The U.S. current account reflects, in part, just how much Americans have benefited from the world's willingness to meet our demand for goods, to hold our debt, and to invest in our projects.

I am confident that our standard of living in the United States would be far lower and our inflation rate higher if we were operating in a trade vacuum.

The current account deficit also does reflect the fact of how the rest of the world has benefited from our willingness to buy foreign-made goods.

Indeed, events of the past couple of years have shown how trading partnerships have helped developing nations pull out of financial trouble, thus averting worldwide economic crisis that I think would have harmed us all.

Of course, I am not suggesting that enhancing wealth is the only goal of a society in building international relationships. Obviously, as I discussed earlier, there are many other legitimate reasons, such as labor rights, working conditions, and the environment, in building international relationships.

But as I've tried to suggest, while they are most important issues, they are not directly trade policy issues and should be addressed in another context.

I also am not suggesting that the act of removing trade barriers by itself assures a nation of prosperity.

Any society that wishes to improve its economic well-being must first embrace a host of other economic and legal principles beyond open trade, must have a legal and market infrastructure in place to handle economic transactions, must have the rule of law and contracts and abide by them.

Its people must be educated, and its fiscal and monetary mechanisms must work.

In other words, a country must develop certain internal systems. Only then can prosperity flow from negotiating, as others have said, fair agreements with other countries to open markets to new competition, open their markets as well as ours.

The country then must develop ways of building products and employing and redeploying resources most productively.

And of course, prosperity requires a system that provides incentives to work, save, and to invest.

Let me turn just a second to this. I think the agenda of today's meeting is, indeed, important. Some people seem surprised as I go around different parts of the country when I tell them that international trade is very important to the Tenth District, a region in our heartland.

But as you have heard from Harry Cleberg this morning and from Alan Barkema of our Bank this morning, also, free and open trade is becoming increasingly important for agriculture. And I can tell you that it is also important for small businesses in this area.

In fact, let me give you a few observations about the impact of free and open trade on this district.

The district ships a wide variety of products to foreign markets, including high-tech on our Eastern Slope in Colorado -- Colorado Springs to Fort Collins, for example -- computer hardware and software. We export commercial jetliners and obviously, food products.

A substantial portion of the district's agricultural bounty is sold abroad, including more than 40 percent of our wheat crop and about 10 percent of our beef production.

And finally, Canada is the leading market for district exports of manufactured products and the third largest for agricultural products, after Japan and Western Europe, for our district.

District exports to Canada have grown rapidly in recent years. Manufactured exports are up nearly two-thirds since the North American Free Trade Agreement was enacted in 1994, and farm exports are up more than a third, as you heard earlier.

In the future -- and let me wrap up here. I know you have a busy afternoon.

But in the future, the United States, as well as nations around the world, will face changes and challenges to our economic well being. This is a simple fact of life. We're going to see a future crisis. There's no question about it. It's just when and where.

But our success will depend on how we choose to react to those events. If we react by barriers to trade, if we engage in a beggar thy neighbor policy, we will surely falter. Our incomes will shrink, and our prosperity will suffer, as will that of our neighbors.

On the other hand, if we react with confidence in our market mechanisms, with patience and foresight, we, I think, will prosper, both now and in the long run, as we have in the past.

Finally, if I can leave you and others with no other point this afternoon, let it be that the country that has worked hard to build and maintain its prosperity or has gone from an underdeveloped nation to a more developed one, that country's economy and society have been outward looking.

How sad it would be if we let our success convince us that we can afford to abandon our commitment to open trade.

How sad it would be also to try and solve our concerns over the current account deficit by shrinking our economy through trade restrictions that will, I think, harm far more Americans than it can possibly help.

Thank you for the opportunity to testify.

MR. ANGELL: Thank you, President Hoenig. We again thank you for your statement and for the provision and use of the facilities by the Federal Reserve Bank of Kansas City.

MR. HOENIG: Thank you. And I look forward to the rest of the afternoon.

MR. LEWIS: May I ask for one clarification?

MR. HOENIG: Sure.

MR. LEWIS: The numbers you used, are those average incomes or median incomes?

MR. HOENIG: Average.

MR. LEWIS: Average. Thank you.

MR. ANGELL: We will now proceed to the fourth panel on agricultural trade.

The first participant in the afternoon panel, Mr. Daniel Amstutz, is President of the North American Export Grain Association.

And even though it's not as well know as Cargill, perhaps, we all recognize the significance, Mr. Amstutz, of your organization's efforts on behalf of agriculture in this region.

Mr. Amstutz.